

DEPARTMENT OF STATE REVENUE

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ISSUE

Qualified Sub Chapter S Subsidiary – QSub or QSSS

Authority: IC 6-2.1-1-2(c); IC 6-2.1-3-24.5; IC 6-3-2-2.6; IC 6-3-2-2.8(2); IRC 332; IRC 368; IRC 381; IRC 1361-1363; IRC 1504

IC 6-3-2-2.8. Exempt organizations.

[T]here shall be no tax on the adjusted gross income of the following:

(2) Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code...

[1984]

IRC 1361. S Corporation Defined.

(b) Small business corporation.

(3) Treatment of certain wholly owned subsidiaries.

(A) In general...

(i) a corporation that is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary

shall be treated as... (those)... of the S corporation.

[1997]

I. "S" CORPORATION – GENERAL STATEMENT

A. Effective for tax years beginning prior to January 1, 1997

In general, the shareholders of an eligible [FN 1] domestic corporation may elect to be treated as a federal and thereafter as an Indiana "S" Corporation (S Corp.) as defined in Internal Revenue Code (IRC) Sec. 1363. [FN 2] An S Corp. may have no more than 35 shareholders each of whom is an individual and not a nonresident alien, there is no more than one class of stock, and the corporation is not a member of an affiliated group. [FN 3] An S Corp. is a "pass through" entity which generally pays no income tax. S Corp. shareholders pay income tax on their individual distributions of S Corp. income.

B. Effective for tax years beginning after December 31, 1996

The prior requirements remain the same except that an S Corp. is limited to 75 shareholders and the percentage of ownership of a subsidiary corporation is no longer limited. The S Corp. may elect to treat certain subsidiaries as a Qualified Sub Chapter S Subsidiary (QSub or QSSS).

A QSub is a corporation that is a 100% owned domestic subsidiary of an S Corp. and is, after its parent's federal election, [FN 4] disregarded as an entity separate from its owner. [FN 5] All QSub assets, liabilities, income, deductions, and credits are reported on the S Corp. federal and Indiana state tax [FN 6] returns as solely those of the S Corp.

A QSub election by its S Corp. parent does not effect the subsidiary corporation's status as an independent separate entity for all other Indiana taxes.

II. INDIANA RETURN AFTER QSUB ELECTION

A. A federal S Corp. which otherwise has no Indiana nexus must file an Indiana S Corp. return if the S Corp. elects to treat a wholly owned subsidiary which has Indiana income as a QSub. The ensuing S Corp. property, payroll, and Indiana destination sales will be included in the numerator of the respective S Corp. apportionment factors.

B. All the assets, liabilities, income, deductions, and credits of a QSub which otherwise has no Indiana nexus must be included in the return of an Indiana S Corp. The property, payroll, and any Indiana destination sales of the former subsidiary will be included in the respective Indiana S Corp. apportionment factors.

III. INDIANA SPECIAL CORPORATION – IC 6-2.1-3-24.5; 45 IAC 1.1-3-11

An Indiana Special Corporation (SC) is a corporation which otherwise qualifies as an S Corp. as defined in IRC § 1361(b) but has not made the required federal election. An Ind. SC is exempt from Indiana Gross Income Tax (GIT).

A corporate subsidiary of an SC that would otherwise qualify as a QSub if its parent had made such a federal election, may not file as an SC. Only a corporation that has made an election to file as a federal S Corp. may make a second federal election to treat its subsidiary as a QSub. [FN 7]

IV. NET OPERATING LOSSES – IC 6-3-2-2.6; IRC 381

A QSub accumulated Indiana net operating loss carryover transferred [FN 8] at the time of an S Corp. QSub election [FN 9] may only be carried forward and applied against S Corp. Indiana income for tax years ending after the date of the election.

V. QSUB ELECTION CONSIDERED TAX FREE LIQUIDATION

A. Adjusted Gross Income Tax – When an S Corp. elects to treat its wholly owned subsidiary as a QSub, the transaction is generally treated as a tax free transaction under either IRC § 332 and 337, "Liquidation", or IRC § 368, "Reorganization". [FN 10] A QSub election generally results in no Indiana Adjusted Gross Income Tax liability.

B. Gross Income Tax – The federal QSub election is exempt from Gross Income Tax as a liquidation of a subsidiary into a parent under IC 6-2.1-1-2(c)(19). [FN 11]

VI. TAXPAYER (EMPLOYER) IDENTIFICATION NUMBER – EIN; TID

After an S Corp. election, a QSub may no longer use its previous federal "Employer Identification Number" (EIN), but instead must use the EIN of its owner. [FN 12] When filing Indiana state and local income and employer withholding returns, a QSub must use the same EIN as that used to file the corresponding federal returns unless the Department's unique "Taxpayer Identification" (TID) is used. All existing Registered Retail Merchants Certificate (RRMC) numbers are unaffected by a QSub election.

[FN 1] Generally all corporations except certain financial institutions, insurance companies, and a DISC.

[FN 2] USCS, Title 26, (Internal Revenue Code) Subtitle A, Chapter 1, Subchapter S, Part I – IV, A/k/a Federal "Small Business Corporation". IC 6- 3-2-2.8(2).

[FN 3] IRC § 1361(b)(2)(A) [Repealed 12/31/96] "Affiliated group" is defined by IRC § 1504. A corporation does not qualify as an S Corp. if it owns 80% or more of a corporate subsidiary.

[FN 4] Temporary Form 966 provided by IRS Notice 97-4, Jan. 13, 1997. Official Form 8869, "Qualified Subchapter S Subsidiary Election" provided Oct. 10, 2000, IRS Notice 2000-58, Nov. 20, 2000.

[FN 5] A/k/a, "Disregarded entity".

[FN 6] Gross Income Tax, Adjusted Gross Income Tax, and Supplemental Net Income Tax.

[FN 7] IRC 1361(b)(3)(B)(ii) The S Corp. must make a written election to treat its subsidiary as a QSub.

[FN 8] As determined by IRC 381 and the IRC 382 special limitations and modified as required by IC 6-3-2-2.6.

[FN 9] 26 CFR 1.1361-4(a).

[FN 10] 26 CFR 1.1361-4(a) Viewed under the "general principles of tax law, including the step transaction doctrine." The "step transaction doctrine" requires an analysis of certain transactions directly preceding a QSub election.

[FN 11] Also see 45 IAC 1.1-6-9 and former 45 IAC 1-1-44.

[FN 12] 26 CFR 301.6109-1(i)(2). Notice 99-6, 1999-3 I.R.B. 12. To prevent potential employee confusion, a QSub may elect to retain its EIN for purposes of federal employment taxes only.